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Article II Complications Surrounding SEC-Employed Administrative Law Judges

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ARTICLE II COMPLICATIONS SURROUNDING SEC-EMPLOYED ADMINISTRATIVE LAW JUDGES

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INTRODUCTION

The country's top white collar defense attorneys spend a great deal of time arguing their cases before a Securities and Exchange Commission ("SEC") administrative law judge ("ALJ"). Even though the function of an ALJ closely resembles that of an Article III judge, the SEC is showing no signs of reducing administrative actions, as ALJs can hear evidence, decide factual issues, apply legal principles, and issue initial decisions at an accelerated rate.[1] This is especially noticeable as the "[e]nforcement activity in the first half of fiscal year 2015 indicates that the [SEC] is on track for another strong year of new enforcement actions filed."[2] This record level of enforcement activity by the SEC is credited to the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank").[3] As a result of Dodd-Frank's central purpose—"[t]o promote the financial stability of the United States by improving accountability and transparency in the financial system, to end

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[1] Kent Barnett, *Resolving the ALJ Quandary*, 66 VAND. L. REV. 797, 798–99 (2013).

[2] Sara Gilley, Heather Lazur & Alberto Vargas, *SEC Focus on Administrative Proceedings: Midyear Checkup*, LAW 360 (May 27, 2015, 10:25 AM), http://www.law360.com/articles/659945/sec-focus-on-administrative-proceedings-midyear-checkup [hereinafter *Midyear Checkup*].

[3] *Id.*

'too big to fail,' to protect the American taxpayer by ending bailouts, [and] to protect consumers from abusive financial services practices"[4]—in 2014 alone, the SEC initiated nearly 1,000 new investigations and filed 755 new enforcement actions.[5]

Defense attorneys, however, came prepared. In a forum where the SEC wins nearly 100% of the time, enforcement action defendants began challenging administrative proceedings against them in federal court. Such defendants received a pivotal decision from the Northern District of Georgia in June 2015 and more recently in November 2015.[6] In both cases, district court Judge Leigh Martin May found that the SEC ALJ hiring process was likely to be unconstitutional because the ALJs were not appointed by the SEC Commissioners pursuant to Article II of the Appointments Clause.[7] Therefore, since Judge May's initial decision, the SEC has been under a flurry of constitutional attacks, as the SEC's breach in "its use of [ALJs] has drawn other defendants like moths to a flame."[8]

There are two constitutional attacks in particular that gained traction, both of which concern the executorial powers of Article II. The first issue is whether SEC-hired ALJs are

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[4] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) (codified as amended in scattered sections of the U.S. Code).

[5] *See Midyear Checkup*, *supra* note 2. However, SEC administrative enforcement statistics were recently contested by Emory University Law Professor Urska Velikonja in her law review article. *See generally* Urska Velikonja, *Reporting Agency Performance: Behind the SEC's Enforcement Statistics*, 101 CORNELL L. REV. 901 (2016). The study concluded that "many of the SEC statistics developed to measure enforcement are deeply flawed" by showing that, between 2002 and 2014, "[t]he distortion in the defendant count" is due to the fact that a large percentage of defendants have been counted twice and sometimes even three or more times in the SEC's statistics. *Id.* at 904 n.9, 977. These added actions typically included "follow-on" enforcement actions—administrative actions that bar individuals from appearing before the commission who were previously found liable for SEC violations—and "secondary" enforcement actions—"filed simultaneously against the same defendant for the same misconduct in court and before the ALJ." *Id.* at 935, 935 n.197, 937. Professor Velikonja's takeaway is that "[o]verstating enforcement statistics is problematic because it suggests that SEC enforcement is more vigorous than it really is." *Id.* at 958.

[6] *See* Hill v. SEC, 114 F. Supp. 3d 1297, 1319 (N.D. Ga. 2015); *see also* Ironridge Glob. IV, Ltd. v. SEC, 146 F. Supp. 3d 1294, 1316 (N.D. Ga. 2015).

[7] *Ironridge Glob.*, 146 F. Supp. 3d at 1316; *Hill*, 114 F. Supp. 3d at 1319.

[8] Peter J. Henning, *S.E.C. Finds Itself in a Constitutional Conundrum*, N.Y. TIMES (June 15, 2015), http://www.nytimes.com/2015/06/16/business/dealbook/sec-finds-itself-in-a-constitutional-conundrum.html.

considered "inferior Officers" of the United States whose appointment shall be in compliance with the Appointments Clause:

> [The President] shall nominate, and by and with the Advice and Consent of the Senate, shall appoint . . . Judges of the supreme Court, and all other Officers of the United States, whose Appointments are not herein otherwise provided for, and which shall be established by Law: but the Congress may by Law vest the Appointment of such inferior Officers, as they think proper, in the President alone, in the Courts of Law, or in the Heads of Departments.[9]

If the United States Supreme Court decides SEC ALJs are inferior officers, then these ALJs are unconstitutionally appointed because the United States Constitution limits the power to appoint inferior officers to three sources: "the President alone," "the Heads of Departments," and "the Courts of Law."[10] SEC ALJs are currently hired by the dual efforts of the SEC Office of Human Resources and the Office of Personnel Management.[11] Both offices conduct their duties and make decisions without any influence from the SEC Commissioners, thus making the ALJs' appointment unconstitutional.[12] In contrast, if the Supreme Court determines that SEC ALJs are mere employees, then the constitutional appointment framework does not affect the way ALJs are hired and the Article II Appointments Clause claim fails.[13]

Analogous to SEC ALJs, in *Freytag v. Commissioner of Internal Revenue*, the Supreme Court addressed whether special trial judges ("STJs") are inferior officers.[14] Concluding STJs are inferior officers because they are "established by Law" and

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[9] U.S. CONST. art. II, § 2, cl. 2.

[10] Freytag v. Comm'r, 501 U.S. 868, 878 (1991); Bandimere v. SEC, 844 F.3d 1168, 1179 (10th Cir. 2016) (finding that because SEC ALJs are inferior officers, the ALJ who presided over [the businessman's] hearing was in conflict with the Appointments Clause for not being appointed by "the President, a court of law, or a department head").

[11] *See* Notice of Filing, Timbervest, LLC, No. 3-15519 (S.E.C. June 4, 2015), https://www.sec.gov/litigation/apdocuments/3-15519-event-139.pdf.

[12] *See Freytag*, 501 U.S. at 878.

[13] *See* Raymond J. Lucia Companies, Inc. v. SEC (*Lucia II*), 832 F.3d 277, 286 (D.C. Cir. 2016) (finding that SEC ALJ's are employees, as "the Commission's ALJs neither have been delegated sovereign authority to act independently of the Commission nor, by other means established by Congress, do they have the power to bind third parties, or the government itself, for the public benefit").

[14] *Freytag*, 501 U.S. at 877–92.

"specified by statute,"[15] the Court considered both the Framers' intent behind the Appointments Clause—to address the "manipulation of official appointments"[16]—and the purpose of the Clause—to "ensure that those who wielded [the power to appoint] were accountable to political force and the will of the people."[17]

The second constitutional issue is whether SEC ALJs' dual for-cause removal protection contravenes the Constitution's separation of powers. Article II of the Constitution provides that "[t]he executive Power shall be vested in a President of the United States of America."[18] As the Supreme Court noted, "[James] Madison stated on the floor of First Congress, 'if any power whatsoever is in its nature Executive, it is the power of appointing, overseeing, and controlling those who execute the laws.' "[19] The underlying purpose of the Clause was to maintain responsibility and harmony in the Executive Department, since "[t]he buck stops with the President."[20] In *Humphrey's Executor v. United States*,[21] the Court initially explored the issue whether good-cause tenure protection constitutionally extended to "principal" officers of independent agencies.[22] It was only until later that Supreme Court decisions answered the question whether removal protections constitutionally extended to inferior officers.[23]

The dual-layered removal protection stems from the protections granted to both the principal officers of the independent agency—the SEC Commissioners—and the inferior officers within those independent agencies—the ALJs. The Court determined that principal officers of independent agencies shall only be removed by the President for "inefficiency, neglect of duty, or malfeasance in office."[24] Yet, the issue remains whether inferior officers shall only be removed by principal agents for cause. An argument made against SEC ALJs is that their dual-

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[15] *Id.* at 881.
[16] *Id.* at 883.
[17] *Id.* at 884.
[18] U.S. CONST. art. II, § 1, cl. 1.
[19] Free Enter. Fund v. Pub. Co. Accounting Oversight Bd., 561 U.S. 477, 492 (2010) (quoting 1 Annals of Cong. 463 (1789)).
[20] *Id.* at 492–93.
[21] 295 U.S. 602 (1935).
[22] *Free Enter. Fund*, 561 U.S. at 493.
[23] *Id.* at 494–95.
[24] *Id.* at 493 (quoting *Humphrey's Ex'r*, 295 U.S. at 620).

layer removal protection would unconstitutionally interfere with the President's control over inferior officers. In *Free Enterprise Fund v. Public Company Accounting Oversight Board*,[25] the Supreme Court addressed this separation of power issue and found that the Public Company Accounting Oversight Board ("PCAOB"), whose members are inferior officers, unconstitutionally interfered with the President's ability to "ensure that the laws are faithfully executed."[26]

This Note argues, first, that SEC ALJs are inferior officers pursuant to Article II's Appointments Clause, and second, that SEC ALJs' multilevel tenure protection is constitutional. Because Supreme Court precedent determined that inferior officers are "established by Law,"[27] hold statutory duties and compensation,[28] exercise "significant authority,"[29] and operate under the supervision of an officer appointed by the President with the consent of the Senate,[30] SEC ALJs are inferior officers, rather than mere employees. Furthermore, since the Supreme Court also concluded that inferior officers are endowed with removal protection as it is "deem[ed] best for the public interest,"[31] notwithstanding the narrow PCAOB ruling in *Free Enterprise Fund*,[32] SEC ALJs' dual-layer protection is not suspect of affecting the President's ability to faithfully execute the laws of the United States.

Part I introduces the legislation underlying both the SEC's development and the ALJ hiring process, including the ALJs' duties and responsibilities within the SEC's Office of Enforcement. Moreover, Part I details the framework of the Supreme Court and D.C. Circuit Court surrounding the Article II Appointments Clause issues. Part II begins with the development of district court cases that first engaged this issue following the enactment of Dodd-Frank. This Part also looks to independent agencies outside the SEC to see how those agencies and Congress responded to the constitutional challenges. Part

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[25] 561 U.S. 477.

[26] *Id.* at 498.

[27] Freytag v. Comm'r, 501 U.S. 868, 881 (1991).

[28] *Id.*

[29] Buckley v. Valeo, 424 U.S. 1, 126 (1976) (per curiam).

[30] Edmond v. United States, 520 U.S. 651, 663 (1997).

[31] United States v. Perkins, 116 U.S. 483, 485 (1886).

[32] Free Enter. Fund v. Pub. Co. Accounting Oversight Bd., 561 U.S. 477, 508 (2010).

III then determines that SEC ALJs are inferior officers and are subject to reappointment by SEC Commissioners. Next, this Part explores a solution to safeguard the anticipated attacks on past and pending ALJ decisions by adopting the *de facto* officer doctrine.[33] Finally, this Part concludes that SEC ALJ dual-layer tenure protection is constitutionally within the separation of powers framework.

I. THE HISTORY AND CURRENT DEVELOPMENT OF SEC-HIRED ALJS

A. *Integration of the Securities Exchange Act and the Administrative Procedure Act*

The 1934 Securities Exchange Act (the "Act") established the Securities and Exchange Commission ("SEC") as the agency responsible for United States federal securities law.[34] Acting as the department heads of the administrative agency, the SEC is composed of five commissioners (together known as the "Commission") who are appointed by the President with the advice and consent of the Senate.[35] The Commission is responsible for "appoint[ing] and compensat[ing] officers, attorneys, economists, examiners, and other employees" so long as their actions comply with § 4802 of the United State Code (the "Code").[36] Indeed, § 4802 of the Code indicates that the section shall be administered consistent with the merit system principles[37] and for the Commission to consult with the Office of

[33] The Supreme Court confirmed that the doctrine "confers validity upon acts performed by a person acting under the color of official title even though it is later discovered that the legality of that person's appointment . . . is deficient." Ryder v. United States, 515 U.S. 177, 180 (1995).

[34] 15 U.S.C. § 78d(a) (2012).

[35] *Id.* (stating that each commissioner holds a five-year term in office).

[36] *Id.* § 78d(b)(1). "The Commission may appoint and fix the compensation of such . . . examiners[] and other employees as may be necessary for carrying out its functions . . . ." 5 U.S.C. § 4802(b) (2012).

[37] See 5 C.F.R. § 332.402 (2016), for OPM's referral procedure and § 332.404 for its order of selection criteria. *See also* 5 U.S.C. § 3313 (explaining the order of qualified applicants).

Personnel Management ("OPM") to incorporate their comprehensive data on prospective ALJ candidates in its hiring decisions.[38]

OPM is the primary source for developing the methodology for ALJ examinations and is the "gatekeeper" for selecting ALJs;[39] however, that is not meant to imply that OPM actually hires ALJs.[40] Rather, it has the authority to (1) recruit and examine ALJ applicants; (2) assure appointment decisions are consistent with applicable laws; (3) establish classification standards; (4) approve personnel actions, such as promotions and transfers; and (5) ensure the independence of ALJs.[41] Accordingly, the appointment responsibilities of ALJs are left to the agency itself.

Following the enactment of the Securities Exchange Act, Congress passed the Administrative Procedure Act (the "APA") in 1946 to further ensure the goals of due process in administrative proceedings.[42] Congress emphasized and answered the concern that hearing officers should hold an independent status apart from the hiring and prosecuting agency.[43] In contemplation of this concern, Congress entertained two proposals: Either "examiners should be entirely independent of agencies, even to the extent of being separately appointed," or "examiners [should] be selected from agency employees and function merely as clerks."[44] Although Congress recognized that agencies have a

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[38] 5 U.S.C. § 4802(d)–(f). The OPM oversees federal employment for ALJs and other civil servants. Brief for Defendant-Appellee at 19, Tilton v. SEC, 824 F.3d 276 (2d Cir. 2015) (No. 15-2103), 2015 WL 4910839, at *40.

[39] Jenna Greene, *SEC Nemesis Mark Cuban Strikes Again-but on the Wrong Side*, AM. LAW. (Sept. 16, 2015), http://www.litigationdaily.com/id=1202737427290/SEC-Nemesis-Mark-Cuban-Strikes-AgainBut-on-the-Wrong-Side.

[40] 5 C.F.R. § 930.201(d). When an agency employs a new ALJ, it must reimburse OPM for the costs it laid out for developing and administering the ALJ examination. *Id.* § 930.203. OPM is in charge of the merit-selection process in which applicants take a test, and the raw points are then processed through a complicated formula to assess the overall score of each applicant. Then, the Chief ALJ of the hiring agency will receive a list of eligible candidates to choose from, Greene, *supra* note 39, and a selection is made from the top three candidates on the list. Notice of Filing, *supra* note 11. Finally, an interview committee and the Chief ALJ make a preliminary selection with the final approval coming from the Commission's Office of Human Resources. *Id.*

[41] 5 C.F.R. § 930.201(e).

[42] 92 CONG. REC. 2149 (1946).

[43] *Id.* at 5655.

[44] *Id.* Congress was grappling with the idea that if it were to give examiners heightened adjudicatory power, then it would also need to make sure the examiners'

legitimate part in the selection of examiners, it determined that "examiners are made independent in tenure and compensation."[45] Put differently, Congress inserted a removal provision for ALJs, which provided that they can only be discharged "for good cause . . . determined by the Civil Service Commission after opportunity for [a] hearing."[46] Therefore, by adding these protections, Congress created enough distance between the Commission and its ALJs to satisfy the independence concern.

In addition, though the Securities Act supplied authority to the Commission to delegate its functions to ALJs and other agency personnel,[47] the Commission retained the "discretionary right" to review the actions of those delegated functions.[48] If, however, the Commission was to decline its exercise to review or fail to make a review in a timely manner, the ALJ's decision will become the final decision of the Commission.[49] But even so, the aggrieved person has the ability to "obtain review of the order in the United States Court of Appeals for the circuit in which he [or she] resides or has his [or her] principle place of business, or for the District of Columbia Circuit."[50] Thus, this multilayered review process, in conjunction with a separate tenure and compensation structure,[51] was Congress's attempt to insulate ALJs from Commission influence.[52]

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appointment was separated from the agencies' influence. Conversely, if Congress were to give examiners less power in the administrative proceeding process, then examiners might become indistinguishable from mere clerks. *Id.*

[45] *Id.*

[46] Administrative Procedure Act, Pub. L. No. 79-404, § 11, 60 Stat. 237, 244 (1946) (codified as amended in scattered sections of title five of the U.S. Code). For cause is to be determined by the Merit Systems Protection Board, as set up under the APA. Harold J. Krent, Symposium, *Presidential Control of Adjudication Within the Executive Branch*, 65 CASE W. RES. L. REV. 1083, 1108 (2015). In addition to their tenure protection, ALJs also have life tenure because they do not serve for a specific period of years in office. Barnett, *supra* note 1, at 807.

[47] 15 U.S.C. § 78d-1(a) (2012); *see also id.* § 77u (establishing that hearings can be held before the Commission or officers designated by the Commission).

[48] *Id.* § 78d-1(b).

[49] *Id.* § 78d-1(c).

[50] *Id.* § 78y(a)(1). Such a filing to the court of appeals must be done within sixty days after the order becomes final. *Id.*

[51] *See generally* 5 U.S.C. § 5372 (2012).

[52] *See* 92 CONG. REC. 5656 (1946).

B. The Operation of the ALJ System within the SEC's Office of Enforcement

The SEC and other independent agencies are required to appoint as many ALJs as necessary to conduct proceedings efficiently and fairly.[53] Currently, the SEC's Office of Administrative Law Judges is composed of five ALJs.[54] When the Commission commences an "order instituting proceeding" to hold an investigatory hearing,[55] it directs one of the ALJs to conduct a public administrative proceeding to determine the truthfulness of the allegations.[56] After the Commission designates an ALJ as an independent judicial officer,[57] the ALJ will conduct a public hearing at one of multiple locations throughout the country.[58]

By statute, an SEC-hired ALJ is a hearing officer,[59] a position that carries significant authority because unless the Commission specifically designates a hearing to an ALJ, the hearing officer presiding over a matter would be the Commission itself or an individual Commissioner.[60] Moreover, as authorized under the APA, ALJs must conduct themselves similarly to court judges during administrative proceedings or else they risk disqualification from the agency at any time.[61] On that basis, ALJs are given substantial power throughout the hearing process to: (1) administer oaths and affirmations; (2) issue subpoenas; (3) rule on evidence; (4) take depositions; (5) hold settlement conferences; (6) demand parties' attendance;[62] and (7) issue sanctions.[63] Though ALJs serve as finders of fact and law, "there is no jury[,] [and] [t]he Federal Rules of Civil Procedure and the

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[53] 5 U.S.C. § 3105.

[54] *ALJ Initial Decisions: Administrative Law Judges*, SEC, https://www.sec.gov/alj/aljdec.shtml (last modified Feb. 6, 2017).

[55] 17 C.F.R. § 201.101(a)(4) (2016).

[56] *Office of Administrative Law Judges*, SEC, http://www.sec.gov/alj (last modified Jan. 26, 2017).

[57] 17 C.F.R. § 201.110.

[58] *Office of Administrative Law Judges*, *supra* note 56.

[59] 17 C.F.R. § 201.101(5).

[60] *See id.*; *see also id.* § 201.110.

[61] 5 U.S.C. § 556 (2012). ALJs participating in the decision of the proceeding must operate in an "impartial manner." *Id.*

[62] *See id.* § 556(c); *see generally* 17 C.F.R. § 201.111 (emphasizing that no provision of the Rules of Practice is meant to curtail the powers of the ALJs unless it explicitly states to the contrary); 17 C.F.R. § 201.320 ("[T]he hearing officer may receive relevant evidence and shall exclude all evidence that is irrelevant, immaterial or unduly repetitious.").

[63] *See generally* 17 C.F.R. § 201.180.

Federal Rules of Evidence do not apply."[64] Accordingly, despite certain similarities between the role of an ALJ and that of an Article III federal judge, the rules of procedure and practice vary significantly between the two types of proceedings.

Above all, ALJs have the power to make initial decisions.[65] When an ALJ drafts an initial decision,[66] "that decision . . . becomes the decision of the agency without further proceedings unless there is an appeal to, or review on motion of, the agency" within the time period that is provided under the Rules of Practice.[67] If the Commission decides to review the initial decision, or a party petitions for review of an initial decision, the Commission reviews *de novo* and has full discretion to "affirm, reverse, modify, set aside or remand for further proceedings, in whole or in part."[68] Although the Commission "retains 'all the power,' "[69] ALJ decisions should not be quickly dismissed as mere recommendations or advisory in nature. After all, absent an appeal or an elected review by the Commission, the initial decision becomes the final decision without any modifications.

C. The Game-Changing Impact of Dodd-Frank on SEC Administrative Hearings

The administrative process, although different from Article III courts, was not nearly as concerning for financial individuals and entities until Dodd-Frank provisions were enacted in 2010. To incentivize the use of administrative enforcement actions, Dodd-Frank enabled the SEC to obtain similar remedies from administrative proceedings as it would from federal court actions, such as the imposition of monetary penalties.[70]

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[64] David Zaring, *Enforcement Discretion at the SEC*, 94 TEX. L. REV. 1155, 1166 (2016).

[65] 5 U.S.C. § 557(b).

[66] *See supra* notes 48–50 and accompanying text.

[67] 5 U.S.C. § 557(b). Depending on a multitude of factors, such as nature, complexity, and urgency, the Commission will specify a time period for the ALJ to conduct the proceeding and file an initial decision. 17 C.F.R. § 201.360(a)(2). Typically, ALJs will be issued either a 120, 210 or 300 day time period. *Id.*

[68] *Id.* § 201.411. The Commission provides at least some deference to the ALJ decision because it must consider the decision during the administrative appeal. Barnett, *supra* note 1, at 807.

[69] Nash v. Bowen, 869 F.2d 675, 680 (2d Cir. 1989) (quoting 5 U.S.C. § 557(b)).

[70] *See* Stephen Joyce, *SEC To Use Administrative Cases More, Despite Defense Bar Complaints, Officials Say*, BLOOMBERG BNA (Nov. 17, 2014), http://

Initially, the 1934 Act limited the SEC to imposing civil money penalties only on enumerated SEC-regulated entities without first having to seek an order from federal court.[71] With the passage of § 929P(a) of Dodd-Frank, however, the SEC's administrative powers have greatly expanded.[72] Pursuant to that section, Dodd-Frank permits the SEC to impose civil money penalties in cease-and-desist proceedings brought against "any person" or unregistered entity.[73] Nonetheless, even though the SEC was granted greater latitude to order both regulated and nonregulated entities before its ALJs, the majority of its proceedings continue to involve only SEC-regulated individuals or firms.[74]

Since the inception of Dodd-Frank, the number of administrative proceedings has increased by fifty percent, as it allows almost any type of securities case to be heard before an SEC ALJ.[75] Specifically, the number of ALJ proceedings has gone from 352 in 2009, pre-Dodd-Frank, to 610 in 2014.[76] The SEC categorizes the types of matters brought before its ALJs into one of eleven primary classifications: (1) Broker-Dealer; (2) Delinquent Filings; (3) Foreign Corrupt Practices Act; (4) Insider Trading; (5) Investment Advisors/Investment

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www.bna.com/sec-administrative-cases-n17179911882. But, according to Professor Urska Velikonja, the Commission did not bring cases before its ALJs to seek an in-house advantage. Mike Sacks, *SEC In–House Venue is Target of House Bill*, NAT'L L.J. (Nov. 2, 2015), http://www.nationallawjournal.com/id=1202741222050/SEC-InHouse-Venue-is-Target-of-House-Bill. In 2009, the SEC won 90.6% of its federal court actions. In 2010, the SEC won 92.6% of its federal court actions. And in 2011, though the SEC had a lower winning percentage in federal court, Professor Velikonja ultimately attributed that to the increase in insider-trading cases. *Id.*

[71] *See generally* Sec. Exch. Act of 1934, Pub. L. No. 73-291, §§ 21–25, 48 Stat. 881, 899–902 (1934) (codified at 15 U.S.C. § 78 (2012)). SEC-regulated entities include: "broker, dealer, investment adviser, investment company, municipal securities dealer, government securities broker, government securities dealer, registered public accounting firm . . . or transfer agent." 15 U.S.C. § 78u–3.

[72] Michael Volkov, *Slowing Down the SEC Administrative Train*, VOLKOV L. BLOG (Sept. 8. 2015), http://blog.volkovlaw.com/2015/09/slowing-down-the-sec-administrative-train.

[73] Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Pub. L. No. 111-203, § 929P(a), 124 Stat. 1376, 1862–65 (2010) (codified as amended in scattered sections of title fifteen of the U.S. Code).

[74] Zaring, *supra* note 64, at 1175.

[75] *Compare* SEC, SELECT SEC AND MARKET DATA FISCAL 2009 TABLE 2 (2009), https://www.sec.gov/about/secstats2009.pdf [hereinafter FISCAL 2009], *with* SEC, SELECT SEC AND MARKET DATA FISCAL 2014 TABLE 2 (2014), https://www.sec.gov/about/secstats2014.pdf [hereinafter FISCAL 2014].

[76] *See* FISCAL 2009, *supra* note 75; FISCAL 2014, *supra* note 75.

Companies; (6) Issuer Reporting and Disclosure; (7) Market Manipulation; (8) Miscellaneous; (9) Municipal Securities & Public Pensions; (10) Securities Offering; and (11) Transfer Agent.[77] Before the enactment of Dodd-Frank, "charges over violations to the securities laws that involved corporate officers or those trading on inside information had to be brought in a federal district court, if the agency was seeking a penalty like a fine or ban from serving as an officer or director of a company."[78] This limited the types of cases that came before ALJs. Both historically and presently, the three major enforcement action classifications brought before an ALJ are Broker-Dealer, Delinquent Filings, and Investment Advisors.[79] In effect, Dodd-Frank has changed the landscape of the securities industry by taking traditionally litigated cases out of the federal court system. Parties to these administrative proceedings are not acquiescing as discussed herein.[80]

D. Development of the Article II Issues within the United States Supreme Court

1. *Freytag v. Commissioner*[81]: Defining "Inferior" Officer

The line between inferior officers and mere employees is far from clear. In the majority opinion by Justice Blackmun, the *Freytag* Court found that special tax judges are inferior officers whose appointments must conform to the Appointments Clause,[82]

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[77] FISCAL 2014, *supra* note 75.

[78] Peter J. Henning, *S.E.C. Faces Challenges Over the Constitutionality of Some of Its Court Proceedings*, N.Y. TIMES (Jan. 27, 2015, 8:58 AM), http://dealbook.nytimes.com/2015/01/27/s-e-c-faces-challenges-over-the-constitutionality-of-some-of-its-court-proceedings.

[79] *See* FISCAL 2009, *supra* note 75; SELECT SEC AND MARKET DATA, FISCAL 2010, Table 2 (2010), https://www.sec.gov/about/secstats2010.pdf; FISCAL 2014, *supra* note 75.

[80] The Director of the SEC Division of Enforcement, Andrew Ceresney, indicated that "while we are using administrative proceedings more, we are still bringing significant numbers of contested cases in district courts. And our use of the administrative forum is eminently proper, appropriate, and fair to respondents." Andrew Ceresney, *Remarks to the American Bar Association's Business Law Section Fall Meeting*, SEC (Nov. 21, 2014), http://www.sec.gov/News/Speech/Detail/Speech/1370543515297.

[81] 501 U.S. 868 (1991).

[82] *Id.* at 881.

which declares that "Congress may by Law vest the Appointment of such inferior Officers, as they think proper, in the President alone, in the Courts of Law, or in the Heads of Departments."[83]

In *Freytag*, the Court addressed where STJs fit on the inferior officer to mere employee spectrum. The United States Tax Court is an Article I court—not an Article III court—and is composed of nineteen judges that are appointed by the Executive.[84] The Chief Judge of the Tax Court is authorized by statute to appoint STJs and assign them to certain specified proceedings and, under a separate subsection, assign them to "any other proceeding which the chief judge may designate."[85] The first three subsections of the statute permit the Chief Tax Judge not only to authorize STJs to hear and report on a case, but also to allow those judges to render a decision.[86] Yet, the fourth subsection authorizes STJs only to prepare proposed findings, leaving the actual decisions to the Tax Court.[87]

The taxpayer defendants in *Freytag* argued that STJs are inferior officers who must be appointed in compliance with the Appointments Clause.[88] Specifically, they contended that because subsections (b)(1), (2), and (3) authorized STJs to issue actual decisions with regard to specific types of proceedings, the catchall phrase in subsection (4) was meant to leave only minor cases for them to write proposed decisions.[89] The taxpayers' stronger argument, however, was that STJs exercised significant authority even where they lacked the authority to enter a final

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[83] U.S. CONST. art. II, § 2, cl. 2.

[84] *Freytag*, 501 U.S. at 870–71. See James E. Pfander, *Article I Tribunals, Article III Courts, and the Judicial Power of the United States*, 118 HARV. L. REV. 643 (2004), for a full discussion on the differences between Article III courts and Article I tribunals. On the surface, Article III judges enjoy life tenure in good behavior and protection from salary reductions, while Article I judges lack both salary and tenure protections. *Id.* at 646.

[85] *Freytag*, 501 U.S. at 871 (quoting 26 U.S.C. § 7443A(b) (2012)). For purposes of the *Freytag* analysis, "the statute" refers to § 7443A(b) of the Internal Revenue Code. In 1991, the statute authorized the chief judge to assign STJs to " '(1) any declaratory judgment proceeding,' '(2) any proceeding under § 7463,' '(3) any proceeding' in which the deficiency or claimed overpayment does not exceed $10,000, and '(4) any other proceeding which the Chief Judge may designate.' " *Id.* at 873 (quoting 26 U.S.C. § 7443A(b)).

[86] *Id.* at 873 (citing 26 U.S.C. § 7443A(c)).

[87] *Id.* It is clear that the fourth subsection states that the "Chief Judge may assign 'any other proceeding' to a special trial judge for duties short of 'mak[ing] the decision.' " *Id.* (alteration in original).

[88] *Id.* at 877.

[89] *Id.* at 876.

decision.[90] Finally, the taxpayers asserted that such judges were unconstitutional because, as inferior officers, they were not appointed by "the President," "the Heads of Departments," or "the Courts of Law."[91]

On the other hand, the Commissioner of Internal Revenue ("CIR") contended that, due to the all-encompassing language in subsection four of the statute, STJs do no more than merely assist the Tax Court through their opinions as recommendations with respect to all disputes.[92] Furthermore, CIR asserted that the first three subsections of § 7443A(b) were meant to cover only minor matters, limiting STJs' actual decision-making power to those minor issues.[93] Accordingly, CIR defined such judges to be mere employees who are not subject to constitutional constraints, as they do not hold significant authority.[94]

The Court found that CIR's argument failed because "[t]he fact that an inferior officer on occasion performs duties that may be performed by an employee not subject to the Appointments Clause does not transform his status under the Constitution."[95] Although the Court held in favor of CIR's broad interpretation of subsection (b)(4),[96] it determined that regardless of whether STJs were restricted to making only proposed decisions under one subsection, the first three subsections of the statute permitted them to exercise independent authority, which is the hallmark of an inferior officer.[97]

The Court ultimately concluded that STJs were inferior officers based on their significant "duties and discretion."[98] Without having to distinguish the first three subsections from the fourth subsection, the Court found that STJs were

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[90] *See id.* at 880–82.

[91] *Id.* at 878, 880.

[92] *Id.* at 880. The legislative history supports the determination that subsection (b)(4) was intended to remove the maximum amount in dispute to expand the authority of STJs. *Id.* at 874 (citing H.R. REP. NO. 98-432, pt. 2, at 1568 (1984)). However, the broader coverage given to STJs came with the caveat of only being authorized to write proposed opinions, leaving the formal decisions to be entered by a tax court judge. *Id.*

[93] *Id.* at 876.

[94] *Id.* at 880–81.

[95] *Id.* at 882.

[96] *Id.* at 877 (holding that STJs can be assigned to any tax proceeding, regardless of its complexity or amount, but only to prepare a recommended opinion).

[97] *See id.* (noting that STJs hear and decide cases under the first three subsections).

[98] *Id.* at 881.

"established by Law" and their "duties, salary, and means of appointment" were specified by statute.[99] Even more to the point, the Court found that STJs' tasks—which included taking testimony, conducting trials, ruling on admissibility of evidence, and enforcing compliance with discovery orders—were significant.[100] Accordingly, even with the discrepancy of authority allocated to STJs under the various subsections of § 7443(b) of the Code, [101] the Court held that they exercised authority "inconsistent with the classifications of 'lesser functionaries' or employees."[102]

Six years later, in *Edmond v. United States*,[103] the Supreme Court found that military appellate judges, specifically, judges on the Coast Guard Court of Criminal Appeals, were also inferior officers.[104] *Edmond* expanded the bright line differences between officers and non-officers when it concluded that inferior officers have their "work . . . directed and supervised at some level by others who were appointed by Presidential nomination with the advice and consent of the Senate."[105] Therefore, the Court determined that judges of the Court of Criminal Appeal—who do not have the power to render final decisions[106]—were inferior officers for the sole reason that their work was supervised by the Judge Advocate General and the Court of Appeals for the Armed Forces.[107]

2. *Landry v. FDIC*[108]: D.C. Circuit Court's Interpretation of *Freytag* Decision in the Context of ALJs as Inferior Officers

In 2000, in the context of independent agencies, such as the Federal Deposit Insurance Corporation ("FDIC"), the D.C. Circuit Court of Appeals decided the question of whether ALJs were considered inferior officers.[109] Similar to the *Freytag* Court, the

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[99] *Id.*
[100] *Id.* at 881–82.
[101] *Id.* at 881 (citing Buckley v. Valeo, 424 U.S. 1, 126 (1976) (per curiam)).
[102] *Id.* at 880–81 (quoting *Buckley*, 424 U.S. at 126, 126 n.162).
[103] 520 U.S. 651 (1997).
[104] *Id.* at 666.
[105] *Id.* at 663.
[106] *Id.* at 665.
[107] *Id.* at 666.
[108] 204 F.3d 1125 (D.C. Cir. 2000).
[109] *Id.* at 1132; *see also id.* at 1128 (noting that the principle issue was whether FDIC's appointment of the ALJ violated the Appointments Clause of the Constitution).

D.C. Circuit also acknowledged that "[t]he line between 'mere' employees and inferior officers is anything but bright."[110] However, the *Landry* court distinguished its conclusion from *Freytag*'s and found that ALJs are not the same as STJs and, therefore, were not inferior officers because they did not hold comparable final decision making power.[111]

In *Landry*, the FDIC notified a senior bank officer that it intended to bring an order against him for conduct that threatened the integrity of a federally insured bank.[112] The FDIC assigned the matter to its ALJ for a formal administrative hearing.[113] After two weeks, the ALJ issued a proposed decision against the bank officer, who then appealed the ALJ initial decision to the FDIC Board of Directors.[114] In its final decision, the FDIC Directors agreed with the ALJ decision and finalized their action against the bank officer.[115] Finally, the bank officer appealed the final decision to the D.C. Circuit and argued that the FDIC's ALJ appointment method violated the Appointments Clause.[116]

The D.C. Circuit emphasized that, unlike the STJs in *Freytag*, who render final decisions under the first three subsections of § 7443(b) of the Code, FDIC ALJs recommend decisions to the FDIC Board, since only the FDIC Board can render final decisions.[117] In addition, unlike the statutory provisions that indicate the Tax Court defers to STJ findings,[118] the court found that the FDIC makes their own factual findings *de novo* without relying solely on the ALJ's finding.[119]

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[110] *Id.* at 1132.
[111] *Id.* at 1134.
[112] *Id.* at 1128.
[113] *Id.*
[114] *Id.*
[115] *Id.*
[116] *Id.*
[117] *Id.* at 1133.
[118] *Id.*
[119] *Id.* (citing 12 U.S.C. § 1818(h)(1) (2012); 12 C.F.R. § 308.40(c) (2016)). However, the concurring opinion made a strong argument that an ALJ's recommended decision subject to *de novo* review is strikingly similar to the proposed findings and recommendations of a federal magistrate judge under the review of a district judge. *Id.* at 1143 (Randolph, J., concurring in part and concurring in the judgment). It is well settled that federal magistrate judges are inferior officers under Article II. *Id.* Nevertheless, even if there were no similarities between the two, "[*d*]*e* [*n*]*ovo* review does not mean that the ALJ's recommended decisions are without influence." *Id.* at 1143 n.3.

However, the court conceded that there were many similarities between ALJs and STJs. Both were "established by Law" and statutory provisions determine their "duties, salary, and means of appointment."[120] Moreover, both "take testimony, conduct trials, rule on the admissibility of evidence, and . . . enforce compliance with discovery orders."[121] Even with those similarities, the court determined that *Freytag* came out the way it did because of the critical final decision making power given to the STJs.[122] Accordingly, the court held that the FDIC ALJ was not an inferior officer subject to the constitutional requirements of the Appointments Clause.[123]

A concurring opinion argued that the court wrongly distinguished STJs from ALJs,[124] as no relevant differences existed between the two.[125] Relying on the Supreme Court decision in *Edmond v. United States*, the concurrence argued that whether or not ALJs can render final decisions should not be dispositive because inferior officers have their work "directed and supervised at some level by others who were appointed by Presidential nomination with the advice and consent of the Senate."[126] In conclusion, the concurring opinion argued that because ALJs are supervised by the review of the FDIC Board members, who are Article II principle agents, they are inferior officers.[127]

3. *Free Enterprise Fund v. Public Co. Accounting Oversight Board* [128]: Dual-Layer Tenure Protection of Inferior Officers

Once a group is designated as inferior officers, the next question is whether an inferior officer's dual-layer tenure protection unconstitutionally insulates the position from Presidential control.[129] In *Free Enterprise Fund*, the Court examined whether "the President [is] restricted in his ability to

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[120] *Id.* at 1133 (majority opinion) (quoting Freytag v. Comm'r, 501 U.S. 868, 881 (1991). *See generally* 5 U.S.C. §§ 556–57, 3105, 5372 (2012).

[121] *Id.* at 1134 (quoting *Freytag*, 501 U.S. at 881–82).

[122] *Id.*

[123] *Id.*

[124] *See id.* at 1140 (Randolph, J., concurring in part and concurring in the judgment).

[125] *Id.* at 1141.

[126] *Id.* at 1142 (quoting Edmond v. United States, 520 U.S. 651, 663 (1997)).

[127] *Id.* at 1143.

[128] 561 U.S. 477 (2010).

[129] *Id.* at 492.

remove a principal officer, who is in turn restricted in his ability to remove an inferior officer, even though that inferior officer determines the . . . laws of the United States."[130] The Court held that such dual-layer tenure protection ran contrary to Article II, emphasizing that the President's judgment should not be hindered by a principal officer's difference of opinion.[131]

The Supreme Court found that the five members, who together made up the Public Company Accounting Oversight Board (the "Board" or "PCAOB"), were indeed inferior officers.[132] The Court comprehensively laid out PCAOB's authority:

> The Board is charged with enforcing the Sarbanes-Oxley Act, the securities laws, the Commission's rules, its own rules, and professional accounting standards. To this end, the Board may regulate every detail of an accounting firm's practice, including hiring and professional development, promotion, supervision of audit work, the acceptance of new business and the continuation of old, internal inspection procedures, [and] professional ethics rules.[133]

PCAOB did not require supervision to promulgate auditing or ethical standards, perform routine inspections of all accounting firms, or initiate formal investigations and disciplinary proceedings.[134] The Board was also able to issue "severe sanctions" in its disciplinary hearings, including money penalties of fifteen million dollars.[135] Although the Sarbanes-Oxley Act placed the Board under the SEC's oversight, particularly in the context of issuing sanctions, the Board possessed significant discretion that was insulated from the SEC's control.[136]

Since PCAOB members were inferior officers, the Court proceeded to the dual-layer tenure protection issue. Removal protections offered to both SEC Commissioners and PCAOB members led to the multi-tiered protection.[137] Though SEC

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[130] *Id.* at 483–84.

[131] *Id.* at 484.

[132] *Id.* at 510. The five-member Board is appointed by the SEC to staggered five-year terms. *Id.* at 484. Although the Board members themselves are considered inferior officers, the PCAOB was created as a private "nonprofit corporation," allowing the Board to recruit employees from the private sector. *Id.* at 484–85 (citing 15 U.S.C. §§ 7211(a), (b), (f)(4), 7219 (2012)).

[133] *Id.* at 485 (citation omitted).

[134] *Id.*

[135] *Id.*

[136] *Id.* at 486.

[137] *Id.* at 495–96.

"Commissioners cannot themselves be removed by the President except [for] . . . 'inefficiency, neglect of duty, or malfeasance in office,' "[138] the issue is whether the enactment of the Sarbanes-Oxley Act of 2002, which enabled the Commissioners to remove Board members in "limited instances for willful misconduct or unreasonable failure to enforce certain rules and standards,"[139] is constitutional. Thus, because Article II of the Constitution states that "[t]he executive Power shall be vested in a President of the United States of America,"[140] an accounting firm registered with the Board argued that PCAOB's multi-tiered protection removed the President's control over the Board members by requiring the approval of the Commission.[141]

The Court held that this added level of protection "chang[ed] the nature" of the President's control.[142] Its concern was that the President could not simply hold the Board accountable if there was a disagreement with any of the Board's determinations, but rather, he could only hold the Commission accountable.[143] Accordingly, the Court found that PCAOB's tenure protection provision was unconstitutional.[144] The majority made clear its decision was not controlling on other inferior officers; its conclusion was specifically tailored to the President's control over PCAOB—"the regulator of first resort and the primary law enforcement authority for a vital sector of our economy."[145]

Justice Breyer—joined by Justices Stevens, Ginsburg, and Sotomayor—dissented on the ground that two layers of protection would not impose any more serious limitation upon the President than a single layer of protection would impose.[146]

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[138] *Id.* at 487 (quoting Humphrey's Ex'r v. United States, 295 U.S. 602, 620 (1935)). The Court did not prevent Congress from providing "good-cause tenure" to principal officers of independent agencies. *Id.* at 493. In addition to regulatory commissions invented during the Progressive Era, independent agencies were also created during the New Deal Era. Kirti Datla & Richard L. Revesz, *Deconstructing Independent Agencies (and Executive Agencies)*, 98 CORNELL L. REV. 769, 770–71 (2013) ("[T]he purpose of these agencies' structural features was . . . to foster[] independence from the President.").

[139] Kent H. Barnett, *Avoiding Independent Agency Armageddon*, 87 NOTRE DAME L. REV. 1349, 1350 (2012).

[140] U.S. CONST. art. II, § 1, cl. 1.

[141] *Free Enter. Fund*, 561 U.S. at 487.

[142] *Id.* at 496.

[143] *Id.*

[144] *Id.* at 492.

[145] *Id.* at 507–08.

[146] *Id.* at 525 (Breyer, J., dissenting).

The dissent's unease stemmed from the statutory provisions of the PCAOB, which illustrated that the SEC had authority over the Board's investigatory power.[147] Therefore, Justice Breyer argued that since the SEC had control over the Board and the President had control over the Commissioners, "then, as a practical matter, the President's control over the Board should prove sufficient as well."[148] Additionally, the dissent asserted that PCAOB's creation in response to "a series of celebrated accounting debacles"[149] created a strong justification to insulate PCAOB members from "losing their jobs due to political influence."[150]

Moreover, the dissent noted that the majority was vague in concluding that such unconstitutional dual-layer protection would apply to all inferior officers.[151] Indeed, the majority opinion even expressed that it was certain the ruling pertained to the PCAOB.[152] The dissent was also troubled by how the Court would apply its holding to other government personnel designated as inferior officers,[153] "putting their job security and their administrative actions and decisions constitutionally at risk."[154]

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[147] *Id.* at 528–29. Pursuant to the Sarbanes–Oxley Act, the dissent listed six reasons why the Commission had full authority: (1) a PCAOB rule could not take effect without the Commission's approval; (2) the Commission can " 'abrogate, delete or add to' any [PCAOB] rule" so long as it furthered the purpose of the securities and accounting-oversight laws; (3) it can "enhance, modify, cancel, reduce, or require the remission of" any sanction the Board imposed; (4) it can restrict PCAOB's inspection and investigation power; (5) it can conduct its own investigation within PCAOB; and (6) it can relieve the Board of any responsibility if doing so is in the best interest of the public. *Id.* (alterations omitted).

[148] *Id.* at 530.

[149] *Id.* at 484 (majority opinion).

[150] *Id.* at 531 (Breyer, J., dissenting).

[151] *Id.* at 536.

[152] *Supra* note 145 and accompanying text.

[153] *Free Enter. Fund*, 561 U.S. at 539 (Breyer, J., dissenting). The dissent listed all the Supreme Court decisions that attempted to define the term "inferior officer," depicting complete ambiguity in the term. *Id.* at 539–40. Moreover, the dissent also included the numerous government positions that the Supreme Court determined to be officers. *Id.* at 540. Among other positions, the dissent also included the FCC's managing director, the FTC's secretary, the Commodity Futures Trading Commission's general counsel, and more generally, bureau chiefs, general counsels, and administrative law judges, as inferior officers. *Id.*

[154] *Id.* at 541.

II. FINANCIAL DEFENDANTS SEEK EQUITABLE REMEDY USING CONSTITUTIONAL CHALLENGES

SEC administrative proceedings have become the buzz around the financial industry throughout 2015.[155] Because Dodd-Frank casted a wide net for SEC administrative proceedings—keeping financial defendants out of federal court—these defendants sought to cure their inability to engage in discovery and to expand the compressed hearing schedule set forth in the Rules of Procedure.[156] In response, defense lawyers asserted that administrative proceedings are unconstitutional pursuant to Article II because (1) ALJs are inferior officers who are not appointed by heads of departments and (2) ALJs' accountability is insulated from two layers of tenure protection that hinders Presidential removal.[157]

A. Article II's Impact on the SEC

Federal courts are inundated with cases that seek an answer to the constitutionality of SEC-hired ALJs. District courts have taken different approaches on this issue, and there is also a recent split of authority among the Tenth and D.C. Circuit Courts.[158] However, other courts concluded that they lack jurisdiction.[159] Moreover, district courts rarely reached the

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[155] *See generally* Jean Eaglesham, *SEC Fights Challenges to Its In-House Courts*, WALL ST. J. (June 21, 2015, 7:06 PM), http://www.wsj.com/articles/sec-fights-challenges-to-its-in-house-courts-1434927977; Henning, *supra* note 78.

[156] *See* Molly M. White & Louis D. Greenstein, *SEC Proposes To Amend Rules Governing Administrative Proceedings*, MONDAQ, http://www.mondaq.com/unitedstates/x/431430/Securities/SEC+Proposes+to+Amend+Rules+Governing+Administrative+Proceedings (last updated Oct. 2, 2015).

[157] *See* Alison Frankel, *Why the SEC Can't Easily Solve Appointments Clause Problem with ALJs*, REUTERS BLOG (June 17, 2015), http://blogs.reuters.com/alison-frankel/2015/06/17/why-the-sec-cant-easily-solve-appointments-clause-problem-with-aljs.

[158] *Compare Lucia II*, 832 F.3d 277, 289 (D.C. Cir. 2016) (holding that "there is no indication Congress intended [SEC ALJs] to be synonymous with 'Officers of the United States' under the Appointments Clause"), *with* Bandimere v. SEC, 844 F.3d 1168, 1188 (10th Cir. 2016) (alteration in original) (citations omitted) ("SEC ALJs carry out 'important functions,' and 'exercis[e] significant authority pursuant to the laws of the Untied States.' The SEC's power to review its ALJs does not transform them into lesser functionaries. Rather, it shows the ALJs are inferior officers subordinate to the SEC commissioners.").

[159] *See, e.g.*, Hill v. SEC, 825 F.3d 1236, 1237 (11th Cir. 2016) (finding "it 'fairly discernible' from the review scheme provided in 15 U.S.C. § 78y that Congress

double-layer tenure protection issue because enforcement action defendants were able to prevail on proving a substantial likelihood of success on the merits using only the Appointments Clause issue.[160]

1. Federal District Court Decisions

Although the D.C. Circuit Court in *Landry v. FDIC* was the first appellate court to issue a decision in connection with the appointment of ALJs,[161] the district courts in the Southern District of New York and Northern District of Georgia are also familiar with these issues.[162]

In the Northern District of Georgia, Judge May ruled on whether SEC ALJs are inferior officers to determine if the appointment of the ALJs violated Article II.[163] Despite the Eleventh Circuit vacating and remanding her judgment with instructions to dismiss for lack of jurisdiction,[164] this Note uses Judge May's findings to substantiate the inferior officer constitutional issue. In *Hill*, the SEC brought an insider trading case pursuant to § 14(e) of the Securities Exchange Act against a self-employed real estate developer—an individual who was unregistered with the SEC.[165] The SEC sought a cease-and-desist order, a civil penalty, and disgorgement.[166]

The district court adopted the *Freytag* analysis to illustrate that ALJs are categorized as inferior officers.[167] The court found that ALJs (1) exercise "significant authority;" (2) are established by law with statutory "duties, salary, and means of appointment;" and (3) are permanent employees that "take testimony, conduct trial, rule on the admissibility of evidence,

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intended the respondents' claims to be resolved first in the administrative forum"); Tilton v. SEC, 824 F.3d 276, 281 (2d Cir. 2016) (finding that Congress intended the SEC's administrative scheme "to preclude district court jurisdiction" (quoting Elgin v. Dep't of Treasury, 132 S. Ct. 2126, 2131 (2012))).

[160] Hill v. SEC, 114 F. Supp. 3d 1297, 1320 (N.D. Ga. 2015), *vacated and remanded* 825 F.3d 1236 (11th Cir. 2016).

[161] *See supra* Section I.D.2 (explaining the *Landry* decision that FDIC ALJs are employees and not subject to Article II constitutional constraints).

[162] *See generally* Duka v. SEC (*Duka II*), No. 15 Civ. 357(RMB)(SN), 2015 WL 5547463 (S.D.N.Y. Sept. 17, 2015); *Hill*, 114 F. Supp. 3d 1297.

[163] *Hill*, 114 F. Supp. 3d at 1316–19.

[164] 825 F.3d at 1252.

[165] *Hill*, 114 F. Supp. 3d at 1301.

[166] *Id.*

[167] *Id.* at 1317.

and . . . issue sanctions."[168] The court, however, conceded that ALJs do not have final order authority to the same degree as STJs in *Freytag*.[169] Even so, the court distinguished *Landry*—which held FDIC ALJs are mere employees due to their inability to render final decisions[170]—and concluded that the powers of STJs were "nearly identical" to those of the ALJs.[171] Finally, it rejected the Commission's argument that since Congress established by statute that ALJs are hired through the Office of Human Resources, and because Congress is aware of the Appointments Clause, ALJs must be employees.[172] Rather, the court found it would be unconstitutional for "Congress [to] . . . 'decide' an ALJ is an employee, but then give [the ALJ] the powers of an inferior officer."[173]

Just as in *Hill*, the Southern District of New York ("S.D.N.Y.") in *Duka v. SEC* concluded that SEC-hired ALJs are inferior officers.[174] The *Duka* court quoted the reasoning and holding from Judge May's opinion in *Hill*.[175] Both courts analogized ALJs to the STJs in *Freytag* and thus, disagreed with the D.C. Circuit's outcome in *Landry*.[176]

Moreover, the United States Court of Appeals for the Tenth Circuit also weighed in on the issue.[177] Unlike the circuit court's reasoning in *Landry* that focused primarily on the SEC ALJ's lack of final decision-making power, the *Bandimere* court found

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[168] *Id.*

[169] *Id.* at 1318, 1318 n.10.

[170] *See supra* notes 117–119 and accompanying text.

[171] *Hill*, 114 F. Supp. 3d at 1318.

[172] *Id.* at 1319.

[173] *Id.* Judge May, however, did not definitively conclude that the Appointments Clause was violated by the inferior office status of ALJs. Rather, she decided that because "SEC ALJ[s] [were] not appointed by the President, a department head, or the Judiciary," the ALJ's "appointment [was] *likely* unconstitutional." *Id.* (emphasis added). The court also did not decide on the second constitutional issue regarding dual tenure protections. *Id.* at 1319 n.12.

[174] *Duka II*, No. 15 Civ. 357(RMB)(SN), 2015 WL 5547463, at *5 (S.D.N.Y. Sept. 17, 2015) ("[ALJs] 'exercise "significant authority pursuant to the laws of the United States," ' their positions are 'established by law,' their 'duties, salary, and means of appointment for that office are specified by statute,' and, in the course of carrying out their 'important functions,' . . . ALJs 'take testimony, conduct trials, rule on the admissibility of evidence, and have the power to enforce compliance with discovery orders.' " (citations omitted)).

[175] Duka v. SEC (*Duka I*), No. 15 Civ. 357(RMB)(SN), 2015 WL 4940057, at *3 (S.D.N.Y. Aug. 3, 2015).

[176] *Id.* at *2 ("The Court is aware that *Landry v. FDIC* . . . is to the contrary.").

[177] Bandimere v. SEC, 844 F.3d 1168, 1179 (10th Cir. 2016).

that final decision-making power is just one factor to consider,[178] as the inferior officer-mere employee distinction should hinge on the ALJs duties as a whole.[179] In addition to finding that SEC ALJs are established by the APA and "receive career appointments,"[180] the court found that they "exercise significant discretion in performing 'important functions,' " such as (1) making credibility findings, (2) "issu[ing] initial decisions that declare respondents liable and impose sanctions," and (3) "sett[ing] aside, mak[ing] permanent, limit[ing], or suspend[ing] temporary sanctions that the SEC itself has imposed."[181] Therefore, just like the United States Supreme Court held in *Freytag*, the Tenth Circuit found SEC ALJs to be inferior officers whose hiring process violates the Appointments Clause.[182]

However, a second S.D.N.Y. judge, in *Tilton v. SEC*, never reached the Article II constitutional issues for procedural reasons.[183] Unlike *Landry*, where the D.C. Circuit's judicial review of the constitutionality of those proceedings occurred after the administrative proceedings, the *Tilton* case was still at the administrative level, preventing the court of appeals from reviewing it until after the SEC rendered a final decision.[184] Therefore, the court declined to preside over the constitutional claims because it found that it did not have jurisdiction over the parties.[185]

In addition, all four cases acknowledged that SEC ALJs are not appointed by the Commissioners. The recent *Duka I* decision also highlighted the disclosures made by the SEC in a separate case, *In re Timbervest*,[186] which outlined the hiring process of its ALJs. Specifically, the affidavit illustrated that the Commissioners did not have any impact or governance over the ALJ selection process.[187] Accordingly, in the event ALJs are

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[178] *Id.* at 1183–84.
[179] *Id.* at 1182.
[180] *Id.* at 1179.
[181] *Id.* at 1180–81.
[182] *Id.* at 1182–83
[183] No. 15-CV-2472 (RA), 2015 WL 4006165, at *1 (S.D.N.Y. June 30, 2015), *aff'd*, 824 F.3d 276 (2d Cir. 2016).
[184] *Id.* at *6.
[185] *Id.* at *13.
[186] *See Duka I*, 2015 WL 4940057, at *2.
[187] *See supra* note 40 and accompanying text.

inferior officers, there is a clear violation of the Appointments Clause and Congress will have to alter the SEC's appointment procedure to come within constitutional boundaries.

2. Recent SEC "Final" Decisions

In stark contrast from federal courts, the SEC came down with two final decisions that fought against the notion that its ALJs are inferior officers. First, in *In re Raymond J. Lucia Companies, Inc.*,[188] the SEC held that "a Commission ALJ is a 'mere employee'—not an 'officer'—and thus the appointment of a Commission ALJ is not covered by the Clause."[189] The SEC supported its conclusion with the same reasoning that reiterated the holding in *Landry*.[190] The Commission found that since ALJs cannot render final decisions, they function "as aides who assist the Board in its duties, not officers who exercise significant authority independent of . . . supervision."[191] In addition, it reasoned that ALJs' status differed from STJs' status in *Freytag* because STJs render final decisions in "significant, fully-litigated proceedings."[192] The United States Court of Appeals for the D.C. Circuit, which denied petition to review the SEC's *Lucia* decision, further held:

> [T]he Commission *could* have chosen to adopt regulations whereby an ALJ's initial decision would be deemed a final decision of the Commission . . . without any additional Commission action. But that is not what the Commission has done. . . . First, it has afforded itself additional time to determine whether it wishes to order review even when no petition for review is filed. Second, upon deciding not to order

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[188] *Lucia I*, Release No. 4190, 2015 WL 5172953 (S.E.C. Sept. 3, 2015). The D.C. Circuit denied the petition to review the SEC's decision. *Lucia II*, 832 F.3d 277, 277 (D.C. Cir. 2016).

[189] *Lucia I*, 2015 WL 5172953, at *2, 21.

[190] The D.C. Circuit Court held that even though *Landry* "did not resolve the constitutional status of ALJs for all agencies . . . [it] is the law of the circuit." *Lucia II*, 832 F.3d at 286 (citations omitted) (determining that "the Commission's regulations on the scope of its ALJ's authority are no less controlling than the FDIC regulations to which [the D.C. Circuit] looked in *Landry*").

[191] *Lucia I*, 2015 WL 5172953, at *21. The D.C. Circuit Court noted, "[T]he main criteria for drawing the line between inferior Officers and employees . . . are (1) the significance of the matters resolved by the officials, (2) the discretion they exercise in reaching their decisions, and (3) the finality of those decisions." *Lucia II*, 832 F.3d at 284 (quoting Tucker v. Comm'r, 676 F.3d 1129, 1133 (D.C. Cir. 2012)).

[192] *Lucia I*, 2015 WL 5172953, at *23.

> review, the Commission issues an order stating that it has decided not to review the initial decision and setting the date when the sanctions, if any, take effect.[193]

Second, in *In re Timbervest, LLC*,[194] the SEC bolstered its reasoning it previously used in *In re Raymond J. Lucia Companies, Inc*. The Commission found that an SEC registered investment adviser wrongly argued the differences between FDIC ALJs in *Landry* and SEC ALJs, as it did no more than illustrate a mere difference in terminology.[195] Thus, the Commission again thought it was appropriate to distinguish SEC ALJs from STJs: (1) ALJ decisions are reviewed *de novo*; (2) ALJ decisions are not final unless the Commission says otherwise; and (3) ALJs cannot enforce subpoenas without "an order from a federal district court to compel compliance."[196] Accordingly, the SEC found that ALJs cannot be considered officers for the purpose of Article II.[197]

In *In re Timbervest*, the SEC also concluded on the dual for-cause tenure protection issue.[198] The Commission distinguished ALJs from PCAOB Board members in *Free Enterprise Fund*. It noted that the Court turned on the fact that the PCAOB tenure structure ran "contrary to 'Article II's vesting of the executive power in the President,' including the President's obligation to 'ensure that the laws are faithfully executed.' "[199] The Commission determined that the Supreme Court did not establish a categorical rule prohibiting two layers of for-cause removal.[200] Therefore, the Commission rephrased the relevant issue to "whether the removal restrictions [on SEC-hired ALJs] [were] of such a nature that they imped[ed] the President's ability to perform *his* constitutional duty."[201]

The Commission cited four reasons for concluding that the dual-layer tenure protection did not infringe on Presidential removal powers.[202] First, the Court in *Free Enterprise Fund*

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[193] *Lucia II*, 832 F.3d at 286 (citations omitted).
[194] Release No. 4197, 2015 WL 5472520, at *1 (S.E.C. Sept. 17, 2015).
[195] *Id.* at *25.
[196] *Id.*
[197] *Id.* at *26.
[198] *Id.*
[199] *Id.* (quoting Free Enter. Fund v. Pub. Co. Accounting Oversight Bd., 561 U.S. 477, 496 (2010)).
[200] *Id.*
[201] *Id.* at *27.
[202] *Id.* at *27–28.

found that the Commission's decision does not apply to independent agency employees, as that would not trigger a separation of powers problem.[203] Second, even if ALJs were considered officers, PCAOB Board members have duties drastically different from ALJs—they were " 'empowered to take significant enforcement actions' and engage in the 'daily exercise of prosecutorial discretion.' "[204] Third, different from ALJs who are subject to immediate SEC review, the "PCAOB had 'significant independence in determining its priorities and intervening in the affairs of regulated firms . . . without Commission preapproval or direction.' "[205] Finally, the Supreme Court was concerned about the PCAOB's lack of historical precedent, not knowing its effect on Presidential authority; this is not the case for the ALJ system, which "has been working effectively for almost 70 years."[206] In consequence, the Commission rejected the dual-layered tenure protection claim against its ALJs.[207]

B. The Impact of Article II Claims on Independent Agencies Outside the SEC

As noted in Justice Breyer's dissent in *Free Enterprise Fund*, there are twenty-eight agencies that, together, employ a total of 1,584 ALJs.[208] Therefore, it is likely that other agencies will look to the SEC ALJ controversy to see how it will affect their own use of ALJs. Likewise, it also makes sense to look to see how other independent agencies addressed this issue, such as the Federal Trade Commission ("FTC") and the U.S. Patent and Trademark Office ("PTO").

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[203] *Id.* at *27.

[204] *Id.*

[205] *Id.* (quoting Free Enter. Fund v. Pub. Co. Accounting Oversight Bd., 561 U.S. 477, 505 (2010)).

[206] *Id.* at *28.

[207] *Id.*

[208] *Free Enter. Fund*, 561 U.S. at 586 (Breyer, J., dissenting).

1. How the FTC Handled Constitutional Challenges Against Its ALJs

The FTC recently issued a final decision in *In re LabMD, Inc*.[209] Corporations subject to FTC regulations challenged that the FTC's administrative proceedings were unconstitutional pursuant to the Appointments Clause.[210] During the enforcement procedure, the FTC remained in full control over the adjudication, even after it assigned the action to a Commission-employed ALJ.[211] Analogous to SEC enforcement action processes, FTC ALJs issue initial decisions, the FTC conducts *de novo* review, and then adopts ALJ decisions in whole, in part, or set aside altogether.[212] Ultimately, the FTC held that its ALJs were mere employees of the Commission due to their limited authority.[213]

However, the FTC added an additional conclusion. It held that, in the event its ALJ is considered an inferior officer, the head of the FTC—an Article II principal agent—"ratified Judge Chappell's appointment as an [FTC ALJ] and as the Commission's Chief [ALJ]."[214] The FTC made exactly the "quick fix" that Judge May had originally suggested the SEC take.[215] In effect, although the FTC concluded its ALJ was not an inferior officer, it endured the extra step to potentially cure subsequent Appointments Clause challenges made by FTC-regulated corporations.

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[209] No. 9357, 2015 WL 5608167, at *1 (F.T.C. Sept. 14, 2015).

[210] *Id.* The FTC also referenced the *Buckley* definition of inferior officer—"one who exercis[es] significant authority pursuant to the laws of the United States." *Id.* (alteration in original) (quoting Buckley v. Valeo, 424 U.S. 1, 126 (1976) (per curiam)).

[211] *Id.*

[212] *Id.* at *2.

[213] *Id.*

[214] *Id.*

[215] Alison Frankel, *Unlike SEC, FTC Makes Quick Fix To Ward Off ALJ Constitutional Challenges*, REUTERS BLOG (Sept. 16, 2015), http://blogs.reuters.com/alison-frankel/2015/09/16/unlike-sec-ftc-makes-quick-fix-to-ward-off-alj-constitutional-challenges.

2. Legislation Answering the PTO ALJ Appointments Clause Issue

In 2008, Congress amended Title 35 of the United States Code and the Trademark Act of 1946.[216] The amendment was in response to the growing concerns raised against the constitutionality of the Director of the PTO who appointed the Administrative Patent and Trademark Judges (collectively, "APJs").[217] As part of a legislative change in 2000, the law provided that APJs were to be appointed by the Director of the PTO, rather than by the Secretary of Commerce—the department head who was initially authorized to appoint such officers.[218] However, after eight years of litigating the 2000 amendment, Congress thought it was necessary to change the law again.[219] Congress argued that, because intellectual property has a significant impact on the U.S. economy, and the success of the industry has been largely due to protections afforded to industry players, the amended appointment of APJs was wholly justified to remove any doubts that the appointments were unconstitutional.[220] Indeed, for there to be a constitutional concern with the appointor of the APJs, it is inferred that Congress categorized APJs to be inferior officers and appointed by department heads.[221]

To cure the constitutional dilemma, Congress enacted a three-part plan.[222] First, the Secretary of Commerce became the department head authorized to make the appointment.[223] Second, the Secretary was permitted to "retroactively appoint

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[216] Trademark Act of 1946, Pub. L. No. 110–313, § 1, 122 Stat. 3014, 3014–15 (2008) (codified at 35 U.S.C. § 6 (2012)).

[217] 154 CONG. REC. 16,853 (2008). The D.C. Circuit held in dicta that APJs are inferior officers on grounds that they are like STJs of the Tax Court in *Freytag*. Stryker Spine v. Biedermann Motech GmbH, 684 F. Supp. 2d 68, 84, 84 n.15 (D.C. Cir. 2010). APJs are officers "established by Law" and have the power to "run trials, take evidence, rule on admissibility, and compel compliance with discovery orders." John F. Duffy, *Are Administrative Patent Judges Unconstitutional?*, 77 GEO. WASH. L. REV. 904, 907 (2009) (citing 37 C.F.R. § 41.125 (2016)). However, unlike SEC ALJs, APJs are members of the appeals board, and thus are authorized by law to render final decisions for the PTO. *Id.*

[218] *Stryker Spine*, 684 F. Supp. 2d at 83 (citing 35 U.S.C. § 6(a) (2000)).

[219] *Id.*

[220] 154 CONG. REC. 16853 (2008).

[221] *See id.* at 16853–54.

[222] *Id.* at 16853.

[223] *Id.*

administrative judges who have been acting as *de facto* judges."[224] Third, the bill gave a defense to these *de facto* judges to counter challenges made against their decisions that were submitted before their constitutional reappointment.[225] The latter two prongs were added because Congress was concerned with those hundreds of decisions rendered pre-enactment by *de facto* judges, which would have been "constitutionally suspect if challenged."[226] To "ensure certainty in the market and to end unnecessary litigation," Congress explicitly addressed these concerns with the *de facto* officer doctrine: "empower[ing] the Secretary to 'deem' or ratify all the appointments made by the PTO Director," and creating the defense to make all those decisions submitted by *de facto* judges immune from collateral attack.[227] These proposals became law on August 12, 2008.[228]

III. A FIX TO THE CONSTITUTIONAL QUARREL

SEC-hired ALJs are indeed inferior officers, and not mere employees. Thus, the SEC Commissioners, as established department heads, will be the officers responsible for appointing ALJs. Moreover, although considered inferior officers, SEC ALJs' dual-layer protection does not impose any significant limitation on Presidential powers.

A. SEC ALJs Are Inferior Officers

Inferior officer has no concrete meaning other than the inconclusive language of the Appointments Clause. Due to this inconclusive language, the term "inferior officer" has been best construed to mean "[a] United States officer appointed by the President, by a court, or by the head of a federal department" and "[a]n officer who is subordinate to another officer."[229]

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[224] *Id.* (emphasis added). A *de facto* judge is defined as "[a] judge operating under color of law but whose authority is procedurally defective, such as a judge appointed under an unconstitutional statute." *De Facto Judge*, BLACK'S LAW DICTIONARY (10th ed. 2014).

[225] 154 CONG. REC. 16853 (2008).

[226] *Id.* at 16854.

[227] *Id.* at 16853–54.

[228] Trademark Act of 1946, Pub. L. No. 110–313, § 1, 122 Stat. 3014, 3014–15 (2008) (codified at 35 U.S.C. § 6 (2012)).

[229] *Inferior Officer*, BLACK'S LAW DICTIONARY (10th ed. 2014).

The SEC-hired ALJs are inferior officers as defined by the United States Supreme Court, rather than mere employees. First, in *Buckley v. Valeo*,[230] the Supreme Court described "Officer of the United States" to include "any appointee exercising significant authority pursuant to the laws of the United States."[231] The Court further acknowledged that "Officer," as used in Article II, was defined to be an inclusive term.[232] As support, the Court emphasized that it had previously established inferior officers to include "postmaster[s]"[233] and "clerk[s] of the [d]istrict [c]ourt."[234] Both positions involved an individual that reported directly to an officer appointed by the President. In the first case, postmasters were "responsible for a local branch of the post office"[235] and were beneath the Postmaster General—"[t]he head of the U.S. Postal Service."[236] In the second case, a clerk was appointed, supervised, and removed by the judge he or she was hired to assist in the United States District Court.[237] In addition, as argued in Justice Breyer's dissent in *Free Enterprise Fund*, the Supreme Court previously categorized, among other positions, clerks in the Department of the Treasury, assistant-surgeons and cadet-engineers appointed by the Secretary of the Navy, election monitors, federal marshals, and military judges as inferior officers.[238]

To further expand the inferior officer term, in *Edmond v. United States*,[239] Justice Scalia reengineered the earlier four-prong "officer" test in *Morrison v. Olson*[240] with a simpler model that emphasized whether or not the individual had a supervisor.[241] In particular, Justice Scalia held, "[I]n the context

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[230] 424 U.S. 1 (1976) (per curiam).

[231] *Id.* at 126.

[232] *Id.*

[233] Myers v. United States, 272 U.S. 52, 60 (1926).

[234] Ex Parte Hennen, 38 U.S. 225, 225 (1839).

[235] *Postmaster*, BLACK'S LAW DICTIONARY (10th ed. 2014).

[236] *Postmaster General*, BLACK'S LAW DICTIONARY (10th ed. 2014).

[237] *See Hennen*, 38 U.S. at 226.

[238] Free Enter. Fund v. Pub. Co. Accounting Oversight Bd., 561 U.S. 477, 540 (2010) (Breyer, J., dissenting).

[239] 520 U.S. 651 (1997).

[240] 487 U.S. 654, 671–73 (1988).

[241] Nick Bravin, Note, *Is* Morrison v. Olson *Still Good Law? The Court's New Appointments Clause Jurisprudence*, 98 COLUM. L. REV. 1103, 1118 (1998) (citing *Edmond*, 520 U.S. at 662).

of [the Appointments Clause] . . . we think it evident that 'inferior officers' are officers whose work is directed and supervised at some level by others who were appointed by Presidential nomination with the advice and consent of the Senate."[242] By making this determination, the *Edmond* Court found Military Appeals Court judges to be inferior officers because they were monitored by the Judge Advocate General and the Court of Appeals for the Armed Forces.[243] Indeed, Justice Scalia went further to conclude that "[b]ased on this supervision . . . [Military] Appeals Court judges 'have no power to render a final decision on behalf of the United States unless permitted to do so by other Executive officers.' "[244]

Second, the SEC and enforcement action defendants have analogized SEC ALJs to or distinguished them from STJs in the *Freytag* decision. However, Justice Blackmun's decision found STJs to be inferior officers not because they can render decisions of the Tax Court under §§ 7443A(b)(1), (2), and (3), and (c), but because they perform "more than ministerial tasks."[245] In addition to the Court's emphasis on STJs being "established by Law" and holding statutory "duties, salary, and means of appointment," the Court ultimately concluded that STJs "take testimony, conduct trials, rule on the admissibility of evidence, and have the power to enforce compliance with discovery orders"—all of which are "exercise[ed] [with] significant discretion."[246]

To this end, even though the court in *Landry* might find the line between mere employees and inferior officers to be anything but bright, the line between inferior officers and SEC-hired ALJs is nonexistent. In particular, the SEC stated in each of its final decisions: "[T]he Commission's ALJs conduct hearings, take testimony, rule on admissibility of evidence, and issue subpoenas."[247] SEC ALJs can also issue sanctions,[248] administer

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[242] *Edmond*, 520 U.S. at 663.

[243] *See* Bravin, *supra* note 241, at 1118.

[244] *Id.* at 1119 (quoting *Edmond*, 520 U.S. at 665).

[245] Freytag v. Comm'r, 501 U.S. 868, 881–82 (1991).

[246] *Id.*

[247] Timbervest, LLC, Release No. 4197, 2015 WL 5472520, at *24 (S.E.C. Sept. 17, 2015); Raymond J. Lucia Companies, Inc. (Lucia I), Release No. 4190, 2015 WL 5172953, at *22 (S.E.C. Sept. 3, 2015).

[248] *See generally* 17 C.F.R. § 201.180 (2016).

oaths,[249] and take depositions.[250] As *Freytag* and *Edmond* made clear, although ALJs only issue initial decisions as opposed to final decisions, such reason does not effectively impact the inferior officer designation.[251] This idea was also delineated in *Landry*'s concurring opinion: "The fact that an ALJ cannot render a final decision and is subject to the ultimate supervision of the FDIC shows only that the ALJ shares the common characteristics of an 'inferior Officer.' "[252]

Accordingly, to hold that SEC-hired ALJs are not inferior officers would go against Supreme Court principles. Although ALJs can be distinguished from STJs in many ways, the principle similarities they do share are the ones that consider them inferior officers. SEC ALJs have statutory roots, well-established duties, and discretion within the SEC, despite them being placed under the Commission's supervision.

B. SEC Commissioners Shall Appoint ALJs and Endure the Protections of the De Facto *Officer Doctrine*

An immediate effect of ALJs being inferior officers is that they are subject to restrictions of the Appointments Clause. The SEC indicated that "[i]t is undisputed that [its ALJs were] not appointed by the President, the head of a department, or a court of law."[253] SEC ALJ Elliot added that he simply sent in his resume, was offered an interview, and received the job.[254] The hiring process was disconnected from the Commission; it did not issue an order appointing Judge Elliot as an ALJ.[255] As a result, the most effective constitutional resolution, despite some criticism against it, is to follow Judge May's "simple fix"[256] and

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[249] 5 U.S.C. § 556(c)(1) (2012).

[250] *Id.* § 556(c)(4); *see also* Bandimere v. SEC, 844 F.3d 1168, 1179–81 (10th Cir. 2016).

[251] *See supra* Section I.D.1.

[252] Landry v. FDIC, 204 F.3d 1125, 1142 (D.C. Cir. 2000) (Randolph, J., concurring in part and concurring in the judgment).

[253] Timbervest, LLC, Release No. 4197, 2015 WL 5472520, at *23 (S.E.C. Sept. 17, 2015); Raymond J. Lucia Companies, Inc. (Lucia I), Release No. 4190, 2015 WL 5172953, at *21 (S.E.C. Sept. 3, 2015).

[254] Trial Transcript Day 19 at. 4472–73, Bebo, File No. 3-16293 (S.E.C. June 19, 2015), https://securitiesdiary.files.wordpress.com/2015/06/sec-june-23-notice-in-timbervest-administrative-proceeding.pdf.

[255] *Id.* at 4474.

[256] Ironridge Glob. IV, Ltd. v. SEC, No. 1:15-CV-2512-LMM, 2015 WL 7273262, at *18 (N.D. Ga. Nov. 17, 2015) (reaffirming the court's earlier conclusion that the

have the Commission reappoint its five ALJs.[257] But, in addition to Judge May's simple fix, this resolution must also contain a retroactive *de facto* judge defense.[258]

Defense attorneys representing financial entities explained that Judge May's solution was untenable because any reappointment made by the SEC "could be construed as an admission that their previous appointments were constitutionally unsound."[259] Thus, the attorneys argued that any previous decision, or pending case, before an SEC ALJ will be constitutionally challenged.[260] To the extent these concerns are valid, Congress already answered similar concerns in the 2008 amendment to the Trademark Act of 1946.[261] Even if Congress does not enact an express *de facto* defense to safeguard the SEC in the 1934 Securities Exchange Act, courts will still not entertain these claims due to the *de facto* officer doctrine.

The *de facto* officer doctrine was exercised in various Supreme Court cases, as discussed herein, to facilitate retroactive application. In *Buckley*, the Court insisted that the Commission's "inability to exercise certain powers because of the method by which its members have been selected should not affect the validity of the Commission's administrative actions and determinations."[262] In response to such statement, the Court rendered *de facto* validity.[263] Similarly, in *Ryder v. United States*, the Court again acknowledged that "[t]he *de facto* officer doctrine confers validity upon acts performed by a person acting under the color of official title even though it is later discovered that the legality of that person's appointment or election to office is deficient."[264]

SEC Commissioners should reappoint the ALJs themselves to cure the Appointment issue); Frankel, *supra* note 157.

[257] Hill v. SEC, 114 F. Supp. 3d 1297, 1320 (N.D. Ga. 2015), (noting that the court's conclusion appears "unduly technical, as the ALJ's appointment could easily be cured by having the SEC Commissioners issue an appointment"), *vacated and remanded sub nom.* Hill v. SEC, 825 F.3d 1236 (11th Cir. 2016).

[258] *See supra* notes 220–224 and accompanying text.

[259] *See* Frankel, *supra* note 157.

[260] *Id.*

[261] *See supra* Section II.B.2.

[262] Buckley v. Valeo, 424 U.S. 1, 142 (1976) (per curiam).

[263] *Id.*

[264] Ryder v. United States, 515 U.S. 177, 180 (1995) (citing Norton v. Shelby Cty., 118 U.S. 425, 440 (1886)). The Supreme Court adopted such doctrine for the very purpose that absurd results would ensue if it were to allow repetitious suits that challenged every action taken by an official whose claim to office was called into

In *Ryder*, the Court listed three cases where it previously used the *de facto* officer doctrine, all of which included defendants who failed to bring an objection against the judges' unconstitutional appointment at the time of the hearing.[265] The defendants raised such objection only in response to the judges' ruling against them.[266] In all three cases, the Supreme Court held that the judges' holdings were not open to collateral attack[267] and "[were] not open to question."[268] In contrast, the *Ryder* case, unlike the challengers in the other three cases, had a petitioner who raised the constitutionality issue regarding the judges' titles before those very judges and *prior* to the commencement of the action.[269] The Court held: "We think that one who makes a timely challenge to the constitutional validity of the appointment of an officer who adjudicates his case is entitled to a decision on the merits of the question and whatever relief may be appropriate if a violation indeed occurred."[270] In sum, the Supreme Court encouraged any objections raised against unconstitutionally appointed judges; however, the Court also made clear that such objections had to be raised before the proceedings commenced. This approach effectively eliminated attacks on prior and pending decisions administered by the *de facto* judges.

Congress enacted this doctrine with respect to APJs within the PTO. Just like the financial industry, the patent and trademark industry largely depends on the decisions made by its ALJs.[271] And, just like the SEC ALJs, APJs were appointed by non-Article II-source principal officers.[272] To nip the appointment issue in the bud, Congress first restored the appointment authority in the Secretary of Commerce and second, adopted the *de facto* judge doctrine to both constitutionalize the ALJs'

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question. *Id.* (citing 63A AM. JUR. 2d, *Public Officers and Employees* § 578, at 1080–81 (1984)).

[265] *Id.* at 181–82 (citing Ball v. United States, 140 U.S. 118 (1891); McDowell v. United States, 159 U.S. 596 (1895); *Ex parte* Ward, 173 U.S. 452 (1899)).

[266] *See Ward*, 173 U.S. at 455–56; *McDowell*, 159 U.S. at 601; *Ball*, 140 U.S. at 128–29.

[267] *See Ward*, 173 U.S. at 456; *McDowell*, 159 U.S. at 601; *Ball*, 140 U.S. at 128–29.

[268] *McDowell*, 159 U.S. at 601.

[269] *Ryder*, 515 U.S. at 182.

[270] *Id.* at 182–83.

[271] 154 CONG. REC. 16853 (2008).

[272] *See id.*

appointment to the date they were originally appointed and to defend against any attacks to prior decisions by making the constitutional appointment apply retroactively.[273] Indeed, no patent and trademark precedent exists that would impugn the Legislature's resolution to the Appointments Clause issue.[274] Therefore, "Congress . . . retains authority to confer validity on determinations adjudicated by previously appointed [administrative] judges and can look to its 2008 modification of the administrative patent-adjudication system as a roadmap for success."[275]

In effect, just as Congress answered the constitutional concerns in the patent and trademark industry, the financial industry can also make these changes to bring it within the constitutional scope. Similar to the Secretary of Commerce—a position that satisfies the heads of department—the SEC Commissioners also hold Article II-source status. First, keeping the appointment within the SEC makes this resolution practical, as any changes made to this agency will certainly have broad impacts on other independent agencies. It would also be unrealistic for Congress to change the appointment power of ALJs to a third-party, or even to an entirely different branch of government.[276] Such proposal might suggest that not only will the five SEC ALJs be appointed by a third-party, but also the remaining 1,500 ALJs from the other agencies.

Second, although enabling the Commission to appoint their own ALJs would seem to invite bias, this will not be the case. The selection process is, and always has been, quarterbacked by the OPM, the office responsible for administering an objective examination that ranks each ALJ applicant.[277] From there, the Chief SEC ALJ and interview committee select the top three test scores and narrow the candidates to the number of ALJs they need.[278] Instead of subjecting the Chief SEC ALJ's recommended applicant to the Commission's Office of Human Resources for

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[273] *Id.*

[274] Greg Louer, Comment, *Copyright at a Crossroad: Why Improper Appointment of Copyright Royalty Judges Could Undermine American Copyright Law, and How Congress Can Solve the Problem*, 60 CATH. U. L. REV. 183, 208 (2010).

[275] *Id.*

[276] For a complete discussion on outer-branch appointment, see Barnett, *supra* note 1, at 832–60.

[277] *See supra* notes 39–41 and accompanying text.

[278] *See id.*

final approval, the applicant will be subject to the Commissioners' final approval. Accordingly, the objective hiring process in place at the beginning of the application process ensures that the Commissioners can only give final approval of the ALJs who were selected for having the best qualifications.

Once SEC Commissioners constitutionally appoint the ALJs—the proposal made by Judge May[279]—it then becomes of utmost importance to make sure these administrative proceedings run efficiently and effectively. Thus, it would behoove the SEC to have Congress enact the *de facto* judge doctrine in its administrative enforcement actions. As a result, any prior or pending proceeding conducted by an ALJ who was unconstitutionally appointed by the SEC Office of Human Resources will not be impaired after the Commission constitutionally reappoints its ALJs. Put differently, this would eliminate any invitation for enforcement action defendants to bring attacks on prior or pending decisions submitted by *de facto* ALJs. Consequently, not only will the appointment of SEC ALJs be constitutional, but the *de facto* judge doctrine will answer and remedy any initial reservation regarding the potential for an increased flux of unnecessary litigation.

C. Double Layer Protection Afforded to SEC-Hired ALJs Is Constitutional

The second Article II challenge should be upheld as constitutional, as multilevel protection from removal granted to SEC ALJs is not contrary to the Article's vesting of executive power in the President. It is determined that independent agencies are headed by principal officers who may be removed for cause.[280] Thus, SEC Commissioners, as principal officers, do not violate Article II because they have a single layer of for-cause protection. The issue is within the ALJs' additional layer of protection, which allegedly limits the President's ability to remove an inferior officer.

First, pursuant to earlier Supreme Court decisions, SEC ALJs' second layer of tenure protection, as inferior officers, is constitutional pursuant to Article II. In *United States v. Perkins*,

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[279] Hill v. SEC, 114 F. Supp. 3d 1297, 1320 (N.D. Ga. 2015), *vacated and remanded*, 825 F.3d 1236 (11th Cir. 2016).

[280] *See* Humphrey's Ex'r v. United States, 295 U.S. 602, 629 (1935).

the Court held that because Congress gave department heads the authority to appoint inferior officers, Congress implied that those same department heads are also limited in removing such officers, as it is "deem[ed] best for the public interest."[281] Indeed, this holding illustrates that it is constitutionally permissible to grant principal officers one layer of protection and inferior officers their own layer of protection as a safeguard to insulate them from improper removal by their department heads.

Second, *Free Enterprise Fund*'s holding has no control over the dual tenure protection granted to SEC-hired ALJs. Notwithstanding its narrow holding that only addressed the PCAOB's added level of protection that deprived the President of adequate control,[282] the Court emphasized that the PCAOB, unlike other inferior officers, had a greater impact on the President's oversight due to the PCAOB's own superior power.[283] The PCAOB's executorial-like powers render its tenure provisions incompatible with the Constitution's separation of powers principle. The argument that *Free Enterprise Fund* is analogous to ALJs because they are both inferior officers is baseless. The Court even addressed that its holding does not apply to ALJs, because, unlike the PCAOB who enforces, and separately, engages in policymaking, ALJs perform strictly adjudicative functions that require approval from their supervisor—the Commission.[284]

Third, Justice Breyer's dissent in *Free Enterprise Fund* should be embraced as the logical conclusion for ALJs' constitutional dual-layer tenure protection. He first argued that the majority's reasoning for restriction on Presidential control was circular.[285] Even though the Court found the Board's powers to be executive in nature, the dissent put forth a list of provisions that prove the Commission had complete power over the PCAOB.[286] Similar to the dissent's view of the Commission's

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[281] 116 U.S. 483, 485 (1886).

[282] Free Enter. Fund v. Pub. Co. Accounting Oversight Bd., 561 U.S. 477, 508 (2010).

[283] *See id.* at 498.

[284] *Id.* at 507 n.10.

[285] *See id.* at 530 (Breyer, J., dissenting).

[286] *Id.* at 528–29. The following includes a list of statutory provisions illustrating the SEC's control over the PCAOB: (1) the SEC must approve each rule; (2) the SEC may abrogate, delete or add to any rule promulgated by the PCAOB;

power over the Board, the Commission also has absolute control over the decisions of ALJs. Consequently, "if the President's control over the Commission is sufficient, and the Commission's control over the Board [or ALJs] is virtually absolute, then, as a practical matter, the President's control over the Board [or ALJs] should prove sufficient as well."[287]

But, assuming the Commission does not have the same type of absolute control over the PCAOB as it does with ALJs, Justice Breyer highlighted the importance and purpose of having an added layer of tenure protection for those inferior officers who engage in adjudicatory functions.[288] Such functions, in which ALJs engage, require the need for an additional for-cause removal process to detach those positions from political influence.[289] Because SEC ALJs can only be removed by the Commission for "inefficiency, neglect of duty, or malfeasance in office,"[290] ALJs may decide cases with the correct application of securities laws, rather than become burdened with any political motives that may emerge.

In sum, without having to apply the ruling in *Free Enterprise Fund* to the dual-layer tenure protection of SEC-hired ALJs, the controlling constitutional standard remains in the *Humphrey's Executor* decision: "Congress may constitutionally 'limit and restrict' the Commission's power to remove those [inferior officers] they appoint."[291] Therefore, the ALJs multilevel tenure protection fails to violate the Constitution's separation of powers, as SEC ALJs do not interfere with the Executive's ability to exercise power over inferior officers.

CONCLUSION

The ALJ-as-inferior officer debate is paramount to the future of SEC enforcement actions. The controversial provisions of Dodd-Frank were the tipping point for SEC regulated and unregulated entities. This prompted enforcement action

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(3) the SEC may modify, enhance, cancel or reduce any sanction made by the PCAOB; and (4) the SEC may restrict or direct PCAOB's conduct. *Id.*

[287] *Id.* at 530.

[288] *See id.* (citing Humphrey's Ex'r v. United States, 295 U.S. 602, 623–28 (1935)).

[289] *Id.* at 531–32. This is another instrument in place to ensure that financial defendants receive the very due process they are challenging.

[290] 5 U.S.C. § 1202(d) (2012).

[291] *Free Enter. Fund*, 561 U.S. at 535 (Breyer, J., dissenting).

defendants to challenge their administrative proceedings in federal court. With the heightened use of ALJs, which embodied the broader principles of Congress's proactive steps to regulate the financial industry, legislative action must be taken to adjust SEC administrative proceedings within the letter of the Constitution. Accordingly, supported by the Supreme Court's interpretation of the Appointments Clause, this Note suggests that SEC ALJs are inferior officers who shall be appointed by SEC Commissioners and have the protections under the *de facto* judge doctrine. Moreover, this Note concludes that SEC ALJs' multi-tiered tenure protection remains constitutional, as there is no basis to support a separation of powers claim.